

## Message Text

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E.O. 11652: N/A  
TAGS: OECD, ECON, GW  
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE  
(EDRC): REVIEW OF GERMANY (APRIL 26)

REF: EDR(78)10 AND ADDENDA

1. SUMMARY: SECRETARIAT DRAFT SURVEY OF GERMAN ECONOMY  
STRAYS FROM THE STRAIGHT-AND-NARROW ON OCCASIONS BY  
ACCEPTING PERHAPS TOO READILY FRG EXPLANATIONS OF GROWTH,  
SHORTFALL, ESPECIALLY THOSE RELATING TO EXCHANGE RATE  
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DEVELOPMENTS, BUT ON THE WHOLE OFFERS ACCEPTABLE ANALYSIS  
OF ECONOMIC FACTORS IN CURRENT POLICY DEBATE (RELYING  
HEAVILY ON PRIVATE GERMAN RESEARCH) WITH CONCLUSIONS  
(A) THAT CURRENT POLICY UNLIKELY TO BE SUFFICIENT TO  
REACH FRG OBJECTIVES AND (B) THAT NO MAJOR ECONOMIC  
CONSTRAINT STANDS IN THE WAY OF GREATER FISCAL STIMULUS'  
MISSION BELIEVES SECRETARIAT RECOMMENDATIONS ARE GEN-

ERALLY ON TRACK, BUT HAS SEVERAL SUGGESTIONS TO MAKE  
ON DETAILS AND PRESENTATION, PER PARA. 8. SINCE  
(A) GERMANY WILL BE A KEY TO EVENTUAL SUCCESS OF CON-  
CERTED ACTION STRATEGY, (B) EDRC PROVIDES IDEAL OCCASION  
TO ENGAGE IN ANALYTICAL DEBATE ON ECONOMIC ASSUMPTIONS  
BEHIND POLICY DECISIONS, AND (C) U.S. IS ONE OF TWO  
EXAMINING COUNTRIES (OTHER IS ITALY), MISSION URGES  
CAREFUL REVIEW OF EDRC DOCUMENTS BY WASHINGTON AGENCIES  
AND EMBASSY BONN TO SUPPORT MISSION EXAMINATION WITH  
UP-TO-DATE INFORMATION AND INCISIVE QUESTIONS. MISSION  
WELCOMES PARTICIPATION OF EMBASSY BONN REPRESENTATIVE  
IN APRIL 26 EDRC REVIEW. END SUMMARY

2. RECENT TRENDS -- TARGETS AND OUTCOME: STARTING FROM  
GERMAN OBJECTIVES FOR 1977 (I.E., 5 PERCENT GROWTH, LESS  
THAN 4 PERCENT UNEMPLOYMENT, INFLATION BELOW 4 PERCENT,  
TRADE SURPLUS OF 2 PERCENT GNP), SECRETARIAT EXAMINES  
PERFORMANCE OF FRG ECONOMY WHICH MET ONLY INFLATION  
TARGET. DOMESTIC FACTORS: SECRETARIAT EXPLAINS GROWTH  
SHORTFALL (TO ONLY 2.4 PERCENT) AS RESULT OF (A) WEAK  
EXPORT DEMAND, WHICH REDUCED GROWTH FROM PROJECTION  
BY 1-1/2 PERCENTAGE POINTS, DESPITE 2 PERCENTAGE POINT  
GAIN IN MARKET SHARES, (B) CONTRACTIONARY IMPACT OF  
FISCAL POLICY, (C) DEPRESSED INVESTMENT CLIMATE WHICH  
HALVED EXPECTED INCREASE IN INVESTMENT, CAUSED PRIN-  
CIPALLY BY LOW CAPACITY UTILIZATION AND HIGH RISK  
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PREMIA. RECORDED UNEMPLOYMENT RATE DID NOT RISE DESPITE  
DECLINE IN EMPLOYMENT, APPARENTLY DUE TO REDUCTION IN  
PARTICIPATION RATES (SINCE EMIGRATION OF FOREIGN WORKERS  
HAS VIRTUALLY STOPPED). DURATION OF UNEMPLOYMENT IS  
LENGTHENING AND STRUCTURE CHANGING ADVERSELY TO "PROBLEM"  
GROUPS, I.E., LOW-SKILLED, YOUTHS, WOMEN, UNIVERSITY-

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EDUCATED. RATE CPI INCREASE FELL TO 3.9 PERCENT IN 1977  
(4.5 IN 1976), AND CONTINUES TO FALL AS FEBRUARY, 1978  
CPI EXCEEDS FEBRUARY, 1977 BY ONLY 3.1 PERCENT DESPITE  
JANUARY VAT INCREASE. PRODUCER PRICES ROSE EVEN LESS,  
DESPITE ACCELERATION IN WAGES AND SALARIES, INDICATING  
THAT PROFITS WERE SQUEEZED ESPECIALLY IN EXPORT GOODS.  
NON-WAGE INCOME, NET OF TAXES, IN FACT DECLINED BY 1-1/2  
PERCENT, WHILE WAGE INCOME ROSE 6 PERCENT.

3. EXTERNAL FACTORS: SECRETARIAT ASSERTS THAT TWO FAC-  
TORS, VIZ. PERSISTENT LARGE FRG CURRENT ACCOUNT SURPLUS  
AND "WEAKNESS OF THE U.S. DOLLAR" EXPLAIN CONTINUED  
STRENGTHENING OF DM IN REAL TERMS SINCE 1975 FOURTH  
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QUARTER, INCLUDING "SPECTACULAR APPRECIATION OF THE DM  
VIS-A-VIS U.S. DOLLAR" SINCE MID-1977. DESPITE DM APPRE-  
CIATION, TRADE SURPLUS FAILED TO FALL IN 1977 AND  
ACTUALLY RECORDED SECOND HIGHEST SURPLUS IN HISTORY.  
(NOTE: SECRETARIAT BOP STATISTICS DO NOT YET REFLECT  
ADJUSTMENTS PER BONN 6872.) IMPORTS INCREASED 5.8 PER-  
CENT (IN VOLUME), PRINCIPALLY IN INDUSTRIAL FINISHED  
GOODS FROM UK, AUSTRIA, SWITZERLAND AND JAPAN. EXPORTS  
WERE WEAK TO TRADITIONAL PARTNERS UNDERTAKING DOMESTIC  
STABILIZATION PROGRAMS (SCANS, FRANCE, ITALY, EAST, BUT  
STRONG TO U.S. (UP 26 PERCENT), AUSTRALIA AND AUSTRIA.  
SECRETARIAT ANALYSIS SHOWS NO LOSS OF MARKET SHARES, BUT  
SOME INCREASE IN IMPORT PENETRATION FOR FINISHED GOODS.

TRADE SURPLUS LARGELY OFFSET BY DEFICIT ON INVISIBLES DUE INCREASED TOURISM DEFICIT AND ABNORMALLY HIGH REMITTANCE OF DIVIDENDS ABROAD, PRESUMABLY TO AVOID JANUARY 1, 1978 TAX CHANGE. THUS, 1977 CURRENT BALANCE WAS LARGELY UNCHANGED FROM 1976. NET LONG-TERM CAPITAL OUTFLOW (DM 12 BILLION) EXCEEDED CURRENT SURPLUS, SUGGESTING THAT UPWARD PRESSURE ON DM WAS DUE TO SHORT-TERM CAPITAL MOVEMENTS.

4. ECONOMIC POLICIES: ON FISCAL SIDE, SECRETARIAT FINDS OUTCOME IN 1977 WAS EVEN MORE CONTRACTIONARY THAN ORIGINALLY INTENDED, DUE TO SHORTFALLS IN EXPENDITURE, PARTICULARLY ON PUBLIC SECTOR INVESTMENT PROJECTS, AND UNEXPECTED STRENGTH OF TAX RECEIPTS (E.G., INCOME ELASTICITY OF WAGE TAXES WAS 2.1 VICE 1.6 EXPECTED). LOCAL GOVERNMENTS SEEM PARTICULARLY HESITANT TO SPEND, POSSIBLY REFLECTING HEAVY DEBT BURDEN ACCUMULATED IN RECENT YEARS. SECRETARIAT NOTES THAT FRG OFFICIAL STATISTICS DO NOT QUICKLY RECOGNIZE VARIANCE OF PERFORMANCE FROM PROJECTIONS, THUS THERE IS DELAYED RECOGNITION OF NEED LIMITED OFFICIAL USE

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FOR POLICY ADJUSTMENT. POLITICAL DIFFICULTIES CREATE FURTHER DELAYS ONCE NEED RECOGNIZED. VARIOUS DEMAND-SUPPORTING MEASURES EVENTUALLY TAKEN DURING 1977 WILL NOT HAVE THEIR PRINCIPAL IMPACT UNTIL 1978. MONETARY AUTHORITIES EASED VARIOUS POLICY INSTRUMENTS IN AIMING FOR 8 PERCENT GROWTH OF "CENTRAL BANK MONEY" (CBM). DURING FIRST HALF 1977, GROWTH OF CBM WAS RIGHT ON TARGET, BUT ATTEMPTS TO MANAGE DM RATE BROUGHT ABOUT STRONG SHORT-TERM CAPITAL INFLOW IN SECOND HALF, CAUSING ACCELERATION OF CBM GROWTH WHICH WAS MAINLY ABSORBED BY DECLINE IN VELOCITY. BUSINESS AND PUBLIC SECTOR DEMAND FOR CREDIT WAS WEAK, WHEREAS CONSUMER CREDIT REMAINED STRONG DUE TO AUTOMOBILE AND HOUSING DEMAND. MONETARY POLICY DOES NOT SEEM TO HAVE RESTRAINED ECONOMIC ACTIVITY, WHEREAS FISCAL POLICY EXERTED CONTRACTIONARY INFLUENCE OF ALMOST 2 PERCENT.

5. MAJOR ISSUES IN PRESENT POLICY DEBATE: SECRETARIAT ANALYZES IN SPECIAL SECTION OF SURVEY FOUR ISSUES WHICH ARE OFTEN CITED AS CONTRIBUTING TO SLOW GERMAN RECOVERY AND LACK OF RESPONSE TO TRADITIONAL DEMAND MANAGEMENT.

(A) ROLE OF WAGES: CITING TWO SCHOOLS OF THOUGHT ON WAGE RISES, ONE WHICH FAVORS HIGHER WAGES TO STIMULATE FIRST CONSUMER DEMAND AND THEN INVESTMENT (PURCHASING POWER PROPOSITION), THE OTHER WHICH ARGUES FOR WAGE RESTRAINT TO REDUCE INFLATION, RAISE REAL NON-WAGE INCOME AND RETURN ON CAPITAL, THUS STIMULATING RISK INVESTMENT (WAGE

RESTRAINT PROPOSITION), SECRETARIAT NOTES THAT ULTIMATE  
OBJECTIVE IS SAME FOR BOTH WHEREAS DIFFERENCE OCCURS IN  
ANALYSIS OF LAGS AND DETERMINANTS OF INVESTMENT DECISIONS  
(CAPACITY UTILIZATION VS. RATE OF RETURN). ECLECTIC  
APPROACH WHICH WOULD COMBINE GREATER EFFECTIVE DEMAND  
WHILE HOLDING DOWN COST, VIA E.G., TAX CUTS, SEEMS TO  
SECRETARIAT TO BE MOST PROMISING.

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(B) UNEMPLOYMENT - CYCLICAL OR STRUCTURAL?: DRAWING ON  
1977 SURVEY AND INDEPENDENT GERMAN STUDIES, SECRETARIAT  
PLACES CYCLICAL UNEMPLOYMENT AT HALF OF REGISTERED TOTAL,

OR 500,000. SECRETARIAT DISTINGUISHES BETWEEN "MEDIUM-TERM" UNEMPLOYMENT DUE TO INSUFFICIENT CAPITAL STOCK AND "STRUCTURAL" UNEMPLOYMENT DUE TO LABOR MARKET MISMATCHES. STUDIES ALSO SHOW THAT NUMBER OF EQUIPPED JOB PLACES IS DECLINING DESPITE NET ADDITIONS TO CAPITAL STOCK, AS RESULT OF HIGHER CAPITAL/LABOR RATIOS IN NEWLY-INSTALLED CAPACITY. INCREASED FIXED INVESTMENT, PARTICULARLY FOR CAPITAL WIDENING, NEEDED TO COUNTERACT GROWING "MEDIUM-TERM" UNEMPLOYMENT. SECRETARIAT EMPLOYS SEVERAL GERMAN LIMITED OFFICIAL USE

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STUDIES (FROM RESEARCH INSTITUTE OF FEDERAL LABOR OFFICE, U. CRAMER PRINCIPAL AUTHOR) TO REFUTE THESIS THAT "STRUCTURAL" UNEMPLOYMENT IS MAJOR CONSTRAINT TO EXPANDING OUTPUT IN CURRENT SITUATION. SECRETARIAT CONCLUDES THAT SUBSTANTIAL REDUCTION IN UNEMPLOYMENT COULD OCCUR BEFORE LABOR MARKET TIGHTENED SIGNIFICANTLY.

(C) LIMITS TO PUBLIC SECTOR DEFICIT SPENDING?: SECRETARIAT CITES EXCESS EX ANTE SAVINGS IN HOUSEHOLD (AND NET PRIVATE) SECTOR AS INDICATION OF FUNDAMENTAL ECONOMIC IMBALANCE WHICH SHOULD SATISFY CONSTITUTIONAL REQUIREMENT FOR GOVERNMENT BORROWING IN EXCESS OF PUBLIC INVESTMENT. FURTHER, SECRETARIAT ANALYZES FRG PUBLIC DEBT SITUATION, IN RELATION TO MONEY MARKET FACTORS AND POSITION OF OTHER OECD MEMBER COUNTRIES, AND CONCLUDES THAT CONSIDERABLE ROOM REMAINS TO INCREASE TOTAL INDEBTEDNESS, WITH ANY UNDESIRABLE DISTRIBUTION EFFECTS AMENABLE TO BE OFFSET BY TAX POLICY. IN SECRETARIAT'S VIEW, DEFICIT FINANCING SHOULD NOT BE CONSTRAINT TO EXPANSIONARY POLICY IF DESIRABLE ON OTHER GROUNDS.

(D) PUBLIC PENSION FUND FINANCE: WHILE ACKNOWLEDGING SERIOUS DETERIORATION OF FINANCIAL POSITION OF PENSION FUND (FROM PROJECTIONS UNDERLYING 1972 REFORMS), SECRETARIAT REGRETS ADOPTION OF POLICIES TO CONSOLIDATE FINANCIAL POSITION WHICH TEND TO RESTRAIN DEMAND (INCREASED PREMIUMS, REDUCED BENEFITS). SOME DELAY IN CONSOLIDATING FINANCIAL POSITION WHILE SUPPORTING FUND FROM PUBLIC SECTOR TRANSFERS WOULD, ON THE OTHER HAND, STIMULATE DEMAND AND HELP MOBILIZE EXCESS SAVINGS.

6. SHORT-TERM PROSPECTS: HEDGED BY DOUBTS ABOUT LIKELY BEHAVIOR OF MONETARY POLICY (GIVEN SHARP CBM INCREASE IN LIMITED OFFICIAL USE

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FIRST QUARTER 1978) AND CONTINUED SLUGGISHNESS OF PUBLIC INVESTMENT, SECRETARIAT FORECASTS REAL GNP GROWTH OF 3 PERCENT IN 1978 WITH SIGNIFICANT DECELERATION BETWEEN THE TWO HALF-YEARS, SUCH THAT GDP GROWTH DURING TWELVE MONTHS TO MID-1979 WOULD BE DOWN TO BELOW 3 PERCENT. (ALTHOUGH SECRETARIAT AND OFFICIAL GERMAN FORECAST FOR 1978 GDP GROWTH ARE SIMILAR, GROWTH PATH DIFFERS CONSIDERABLY SINCE FRG EXPECTS STEADY ACCELERATION AT 4-1/2 PERCENT THROUGH THE YEAR.) OUTPUT GROWTH WILL BE BELOW RISE IN PRODUCTIVITY AND WOULD THEREFORE RESULT IN SOME DETERIORATION IN LABOR MARKET, WITH FURTHER CONTRACTION OF EMPLOYMENT. THUS, SECRETARIAT EXPECTS SOME RISE IN UNEMPLOYMENT RATE. DEMAND COMPONENTS ARE FORECAST AS FOLLOWS:

-- PRIVATE CONSUMPTION UP 3-1/4 PERCENT ON BASIS OF NOMINAL 7-1/4 PERCENT GROWTH IN DISPOSABLE INCOME AND SLIGHT RISE IN SAVINGS RATE DUE TO SOMEWHAT FASTER GROWTH OF NON-WAGE INCOMES (UP 8 PERCENT). HOURLY WAGES AND TOTAL EARNINGS ARE ASSUMED TO INCREASE 5-1/2 PERCENT.

-- PRIVATE INVESTMENT UP SLIGHTLY OVER 4 PERCENT, ABOUT EQUALLY DIVIDED BETWEEN CONSTRUCTION AND MACHINERY AND EQUIPMENT. THIS PROJECTION IS BASED ON HIGH LIQUIDITY AND STRONG RECOVERY OF PROFIT MARGINS AND IS HIGHLY SENSITIVE TO THOSE FACTORS. STOCKBUILDING SHOULD BE NEUTRAL.

-- GOVERNMENT IS CALCULATED TO MAKE NET POSITIVE CONTRIBUTION OF 1-1/2 PERCENT, WITH PROGRESSIVE TAX STRUCTURE BEGINNING TO RE-EXERT DRAG BY END-1978.

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-- FOREIGN SECTOR WILL BE SMALL NEGATIVE FACTOR AS WEAK-  
NESS CONTINUES IN EXPORT MARKETS (EXPORTS VOLUME UP  
3-1/2 PERCENT), WHILE IMPORT VOLUME WILL RISE NEAR 6  
PERCENT. NOTE THAT SECRETARIAT FORECAST ASSUMES NO  
FURTHER EXCHANGE RATE CHANGES (AFTER APRIL CUT-OFF  
DATE), THUS INTRODUCING ADDED ELEMENT OF UNCERTAINTY  
IN FOREIGN SECTOR PROJECTION. IN NOMINAL TERMS,  
PRICE DEVELOPMENTS WILL OVERWHELM VOLUME CAUSING PRO-  
JECTED 1978 CURRENT SURPLUS SUBSTANTIALLY TO EXCEED  
1977 LEVEL (DM 10 BILLION VS. 8.2).

7. CONCLUSIONS: ON BASIS OF ITS ANALYSIS, SECRETARIAT  
SUGGESTS FOLLOWING CONCLUSIONS:  
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(A) GERMAN DOMESTIC DEMAND SHOULD INCREASE CURRENTLY AT  
A SUFFICIENTLY RAPID PACE TO ALLOW A GRADUAL REDUCTION  
IN LABOR MARKET SLACK AND THE CURRENT EXTERNAL SURPLUS:  
AN EARLY SWING OF THE LATTER INTO DEFICIT WOULD BE WEL-  
COME FROM THE INTERNATIONAL POINT OF VIEW. SINCE THE  
FISCAL AND MONETARY STIMULUS INJECTED SO FAR INTO THE  
ECONOMY DOES NOT SEEM TO BE SUFFICIENT TO GENERATE A  
SELF-SUSTAINED BUSINESS UPSWING, FURTHER MEASURES WOULD  
BE REQUIRED.

(B) THE RECENT REAL APPRECIATION OF THE DEUTSCHEMARK  
WOULD BE EXPECTED TO REDUCE GERMANY'S EXPORT PROSPECTS  
IN ALREADY WEAK WORLD MARKETS AND HAS EXERTED PRESSURE  
ON PROFIT MARGINS IN THE EXPOSED SECTORS OF THE ECONOMY'  
SINCE -- EXCEPT IN THE SHORT RUN -- IT IS IMPOSSIBLE  
FOR GERMANY TO CONTROL THE DEUTSCHEMARK EXCHANGE UNI-  
LATERALLY, EVEN IF IT WISHES, DOMESTIC DEMAND GROWTH  
EXCEEDING THAT OF MAJOR TRADING PARTNERS WOULD SIGNIFI-  
CANTLY CONTRIBUTE TO MORE STABLE EXCHANGE RATE DEVELOP-  
MENTS. GIVEN THE EXISTING LARGE MARGIN OF SLACK THE  
RISK OF REKINDLING INFLATIONARY PRESSURE WOULD SEEM



RATHER SMALL.

(C) A RAPID RECOVERY OF BUSINESS FIXED INVESTMENT IS ESSENTIAL BOTH FOR ESTABLISHING A SUSTAINABLE UPSWING AND FOR SOLVING THE MEDIUM-TERM UNEMPLOYMENT PROBLEM. AMONG THE VARIOUS FACTORS AFFECTING INVESTMENT DECISIONS ACTUAL AND EXPECTED HIGH DEGREES OF CAPACITY UTILIZATION IN COMBINATION WITH MODERATE WAGE COST DEVELOPMENTS ARE NECESSARY CONDITIONS TO INDUCE CAPITAL WIDENING (I.E., JOB-CREATING) INVESTMENT. APART FROM DIRECT TAX AND OTHER FINANCIAL CONCESSIONS FOR BUSINESS INVESTMENT, ONE LIMITED OFFICIAL USE

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POSSIBLE WAY OF SIMULTANEOUSLY SUPPORTING REAL DISPOSABLE INCOMES AND DEMAND AND REDUCING COST PRESSURES WOULD BE A CUT IN WAGE TAXES COMBINED WITH VOLUNTARY RESTRAINT ON NOMINAL WAGE INCREASES.

8. MISSION COMMENTS:

(A) SECRETARIAT ANALYSIS OF 1977 GROWTH SHORTFALL RELIES HEAVILY ON WEAK EXPORT PERFORMANCE AS CAUSAL FACTOR. MISSION FEELS THAT SECRETARIAT IS BASICALLY IN A BOX CREATED BY THEIR (AND GERMANS) TECHNICAL FORECASTING ASSUMPTION OF "NO FURTHER CHANGE IN EXCHANGE RATES." WHILE THIS ASSUMPTION MAY BE NECESSARY, EVEN DESIRABLE, IN CONSTRUCTING FORECAST, IT IS NOT NECESSARILY APPROPRIATE IN JUDGING PERFORMANCE SINCE IT IS BASICALLY AN ASSUMPTION ABOUT WHAT WOULD HAVE HAPPENED IN A FIXED RATE SYSTEM GIVEN FORECAST BEHAVIOR OF OTHER VARIABLES. IT ALSO GIVES COUNTRIES WITH APPRECIATING CURRENCIES A CONVENIENT EXPLANATION OF WHY GROWTH WAS BELOW "EXPECTATIONS." GIVEN LARGE AND PERSISTENT CURRENT ACCOUNT SURPLUS AND RELATIVELY VERY LOW RATE OF INFLATION, ASSUMPTION OF NO FURTHER EXCHANGE RATE CHANGE WAS AT BEST ONLY TECHNICAL FOR FRG IN 1977 AND GOVERNMENT POLICY SHOULD HAVE BEEN GEARED FOR SOME APPRECIATION. IN GERMAN CASE, THEREFORE EXPORT FORECAST FOR 1977 WAS QUITE UNREALISTIC. RECORD SHOWS IN FACT THAT DESPITE APPRECIATION NO EXPORT MARKET SHARES WERE LOST IN 1977, ALTHOUGH LAGS MAY NOT YET HAVE HAD TIME TO SHOW UP. MISSION BELIEVES THAT SECRETARIAT ANALYSIS OF 1977 EXPORTS SHOULD RELY LESS ON DEVIATION FROM FORECAST, BASED ON TECHNICAL ASSUMPTIONS, AND LOOK MORE CAREFULLY, AND PROMINENTLY, AT NON-GROWTH OF MARKETS WHICH WERE CONSTRAINED IN PART BY FAILURE OF GERMANY TO PROVIDE ADEQUATE MARKET FOR OTHER'S EXPORTS.

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(B) ON SAME LINE, SECRETARIAT REPEATEDLY CITES "UNFAVOR-  
ABLE" PRESSURE ON PROFITS IN EXPORT INDUSTRIES DUE TO DM  
APPRECIATION. THEORETICALLY, SUCH PRESSURE IS ESSENTIAL  
PART OF ADJUSTMENT PROCESS FROM EXPORT TO DOMESTIC ORIEN-  
TATION OF INDUSTRIAL STRUCTURE. WE PLAN TO ELABORATE ON  
THIS POINT NOTING THAT DEPRESSED INVESTMENT CLIMATE IS  
BASICALLY DUE TO INSUFFICIENT DOMESTIC DEMAND TO CREATE  
PROFIT OPPORTUNITIES IN DOMESTIC MARKET, WITH RESULT THAT  
SQUEEZED RESOURCES IN EXPORT SECTOR HAVE NOWHERE TO GO.  
IT WOULD SEEM APPROPRIATE TO ASK IF GERMAN AUTHORITIES  
INTEND TO ADOPT POSITIVE ADJUSTMENT MEASURES TO ENCOUR-  
AGE AND HASTEN THIS ADJUSTMENT TO DOMESTIC MARKET. IN ANY  
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CASE, WE PLAN TO SEEK REVISIONS OF TEXT WHICH WILL BETTER  
REFLECT DESIRABLE ASPECTS OF ADJUSTMENT.

(C) SECRETARIAT DRAFT MAKES SEVERAL REFERENCES TO NEED FOR MORE EXPLICIT USE OF TAX MEASURES IN CONTEXT OF INCOMES POLICY. GIVEN GERMAN OBJECTIONS TO FORMAL INCOMES POLICY, WE BELIEVE DRAFT SHOULD BE CHANGED TO ENCOURAGE SAME END RESULT WITHOUT RECOMMENDATION THAT TAX CUTS AND WAGE RESTRAINT BE ORGANICALLY LINKED.

(D) SECRETARIAT ANALYSIS OF ROLE OF WAGES (SEE PARA. 5A ABOVE) IN GROWTH PROCESS RECOGNIZES VALIDITY OF BOTH "WAGE RESTRAINT" AND "PURCHASING POWER" PROPOSITIONS. ARE RESOURCES AVAILABLE IN WASHINGTON TO GIVE MISSION SOME INDICATION OF DIFFERENTIAL EFFECTS OF VARIOUS WAGE SETTLEMENTS WITHIN RELEVANT RANGE?

(E) MISSION INTENDS TO QUESTION GERMAN DELEGATION ON STATUS OF AND PROGRESS ON PUBLIC SECTOR INVESTMENT PROGRAM. WE WOULD APPRECIATE LATEST INFORMATION FROM BONN AND WASHINGTON ON THIS SUBJECT TO BE USED AS BACKGROUND. FOR EXAMPLE, WE MAY ASK: HAVE THERE BEEN MAJOR BREAKTHROUGHS ON NUCLEAR QUESTION? (PERHAPS THIS IS SOMETHING WE SHOULD AVOID GIVEN ROW OVER FUEL SUPPLY?) DO LAENDER GOVERNMENTS SEEM MORE INCLINED TO SPEND AVAILABLE FUNDS?

(F) IN RECENT EPC/WP-2 MEETING (PARIS 10036), BUNDESBANK REP STATED THAT BANK WOULD NOT PERMIT INFLATION RATE TO REACH LEVELS SECRETARIAT SUGGESTED WOULD BE CONSISTENT WITH HIGH EMPLOYMENT GROWTH PATH, I.E., 5-1/2 PERCENT IN 1985. WITHOUT QUARRELING OVER EXACT FIGURES, IT SEEMS FROM SECRETARIAT ANALYSIS OF REAL INTEREST RATES THAT MONETARY CONDITIONS HAVE BEEN TIGHTENING IN RECENT MONTHS, LIMITED OFFICIAL USE

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DESPITE BEHAVIOR OF AGGREGATES. MISSION PLANS TO QUESTION GERMAN DELEGATION ABOUT INTENTIONS FOR MONETARY AGGREGATES DURING REMAINDER OF 1978, GIVEN SHARP FIRST QUARTER INCREASE, AND WHETHER MONETARY AUTHORITIES ARE PREPARED TO ACCOMMODATE RECOVERY WHEN IT COMES.

(G) MISSION WOULD APPRECIATE WASHINGTON'S LATEST FORECAST OF GERMAN ECONOMY FOR 1978 AND ANY ANALYSIS OF EXPECTED BEHAVIOR OF CURRENT BALANCE AS RESULT OF DM APPRECIATION ALONG LINES OF RECENT CIA STUDY OF YEN APPRECIATION.

(H) UNLESS GERMAN DELEGATION CAN PROVIDE CONVINCING ARGUMENTS THAT SECRETARIAT'S 1978 GROWTH PROFILE IS ERRONEOUS, MISSION PLANS TO STRONGLY SUPPORT SECRETARIAT CONCLUSION THAT CURRENT MEASURES DO NOT PROVIDE SUFFICIENT STIMULUS TO REACH GERMAN TARGET FOR 1978 (ESPECIALLY ON

PROFILE) AND PURSUANT RECOMMENDATION THAT ADDITIONAL MEASURES ARE REQUIRED. WE WOULD PUT THIS POINT SQUARELY IN CONTEXT OF CONCERTED ACTION STRATEGY PER FEBRUARY EPC CONCLUSIONS.  
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## Message Attributes

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